PROVO
WEALTH MANAGEMENT GROUP

MAPPING YOUR RETIREMENT

to minimize your taxes

"Often when you think you're at the end of something, you're at the beginning of something else."

–FRED ROGERS

You save for decades for the day you'll leave the workforce behind. But there's one thing that will follow you into retirement, and it's something many Americans aren't prepared for– taxes. In fact, without proper planning, taxes can be one of the largest expenses of your golden years. A little knowledge and preparation go a long way, so take steps now to minimize your offering to the IRS.

HERE ARE 6 TAXABLE SITUATIONS YOU CAN PLAN FOR NOW:

#1 NON-QUALIFIED ASSETS– INCLUDING TAXABLE GAINS

Interest paid on investments in taxable accounts is taxed at your ordinary income tax rate. But other income—from both your capital gains and qualifying dividends—could be taxed at the long-term capital gains rate of between 0% and 20%, depending on your tax bracket. This happens when you have owned the investment for more than one year. This lower tax rate is one of the major advantages of taxable accounts, though it's not the only one. There are no required withdrawals from taxable accounts and no tax penalty for taking income from these accounts before you turn age 59½. This means you have more flexibility in deciding which investments to tap for income and which to preserve for later needs.

There are also ways to minimize the taxes that may be due. You can use capital losses on some investments to offset capital gains on others. You may be able to bunch or defer income to a single tax year or take advantage of tax deductions and credits. Or you could purchase investments that pay little current income but have strong growth potential. Another approach you may want to consider is to make charitable gifts of assets that have increased in value. This technique may allow you to avoid capital gains taxes while taking a tax deduction for the current value of the asset.

#2 RETIREMENT PLAN ASSETS– IRA, 403(B), 401(K), ROTH IRA

Many Americans are contributing to a retirement plan of some sort, whether it's a 401(k) or 403(b), through their employer. Many others also own an IRA. These plans allow you to save for retirement on a pre-tax basis, and your contributions are not counted as income in the year made.

When you take distributions from your traditional 401(k), 403(b) or IRA, you'll owe income tax on those amounts. This income, which is produced by the combination of your contributions, any employer contributions and earnings on the contributions, is taxed at your ordinary income tax rate. In addition, if you take distributions prior to age 59½ you may be subject to an additional 10% tax penalty.

If you have a Roth IRA, you'll pay no tax at all on your earnings if you've had the Roth IRA for at least five years and are at least age 59½ when you take distributions. This is because the Roth has been funded with post-tax dollars. If you take distributions that don't meet those criteria, you may be subject to a 10% federal tax penalty. Often, advisors encourage clients with IRAs to consider a full or partial Roth IRA conversion now and pay the taxes due before retirement. This reduces your taxable income in retirement and puts more money in your pocket when you may need it most.

#3 TRADITIONAL PENSIONS (DEFINED BENEFIT PLANS)

If you are one of the lucky few who still have access to a pension, you will owe ordinary income tax as you receive periodic pension payments. But if you take a direct lump-sum payout from your pension instead, you must pay the total tax due when you file your return for the year you receive the money. In either case, your employer will withhold taxes as the payments are made, so at least some of what's due will have been paid. If you rollover a lump sum directly to an IRA, taxes will be deferred until you start taking distributions.

Smart Tip: Taxes on Pension Income Vary by State

It's a good idea to check the different state tax rules on pension income. Some states do not tax pension payments while others do. In addition, states can't tax pension money you earned within their borders if you've moved your legal residence to another state. For instance, if you worked in Minnesota, but now live in Florida, which has no state income tax, you don't owe any Minnesota state income tax on the pension payments you receive from your former employer.

#4 SOCIAL SECURITY

Many older Americans are surprised to learn they might have to pay taxes on part of the Social Security income they receive. Whether you have to pay such taxes will depend on how much overall retirement income you and your spouse receive, and whether you file joint or separate tax returns.

Generally, the higher that total income amount, the greater the taxable part of your benefits. This can range from 50% to 85% depending on your income. There is no tax break if you're married and file separate returns. The IRS also provides worksheets you can use to determine what's taxable and how much you might owe in taxes on your retirement income. You can find these worksheets in *IRS Publication 554, Tax Guide for Seniors.*[1]

There are a number of strategies you can use to help reduce taxes on your Social Security income. For example, since taxation of your benefits is affected by your overall taxable income, take steps to manage your retirement income sources. Distributions from Roth IRAs after age 59½ from an account that is at least 5 years old are not taxable and don't contribute to the taxation of your Social Security benefits. Saving for retirement in an after-tax Roth account sets you up for tax-free withdrawals in retirement, and also allows you to minimize taxes on your Social Security payments.

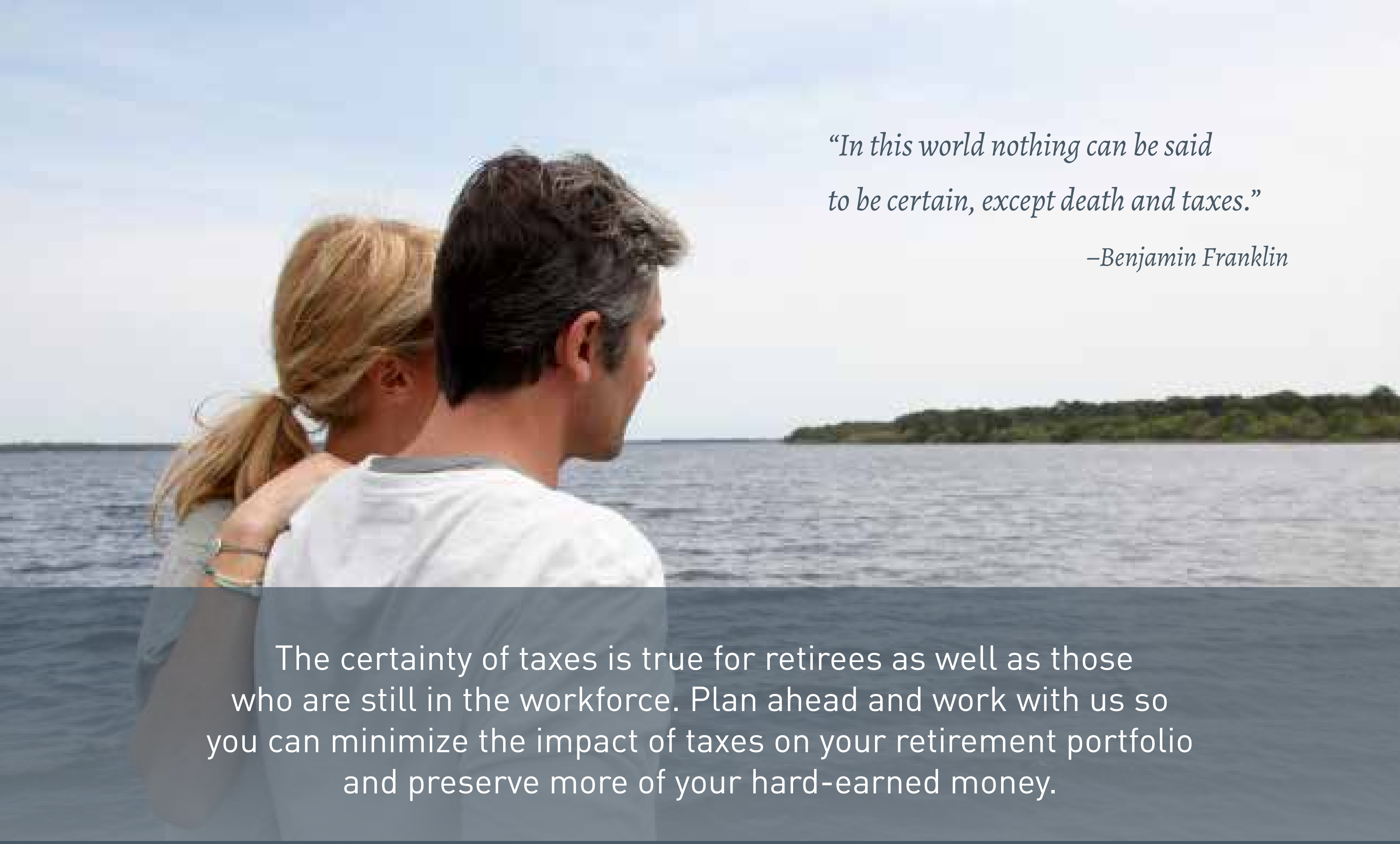
#5 LIFE INSURANCE

Life insurance proceeds paid to a beneficiary upon the death of the insured are generally income tax-free. So are withdrawals of the cash value portion of a permanent life insurance policy or policy loans taken against that value.[2] However, if your policy is deemed a Modified Endowment Contract (MEC), which means it is heavily-funded according to IRS calculations, any interest you receive will be taxable and may be reportable as interest received. Be sure to check with your tax advisor about this.

#6 ANNUITIES

Some or all of the income you receive from an annuity is taxable at ordinary income tax rates. If you hold the annuity outside of a qualified retirement account, the portion of the payment that represents the return of your investment, known as the exclusion amount, is tax-free. The remainder is taxable. But if you hold the annuity inside a traditional retirement account, 100% of the payouts are taxed at ordinary income tax rates.

There are ways to minimize the tax bite of a retirement plan funded by an annuity. For example, if you purchase an annuity to fund your IRA and name your spouse as the primary beneficiary, he or she will be able to resume the annuity in their own name upon your death. This means that payments from the annuity can be made based on his or her own life expectancy as opposed to cashing it in and paying taxes on the full amount at once. (This option is generally available to spousal beneficiaries only, with exceptions for minor or disabled children). This stretching of the IRA payments can help your surviving spouse better manage their taxes throughout their own lifetime.



"In this world nothing can be said to be certain, except death and taxes."

–Benjamin Franklin

The certainty of taxes is true for retirees as well as those who are still in the workforce. Plan ahead and work with us so you can minimize the impact of taxes on your retirement portfolio and preserve more of your hard-earned money.

Contact us today.
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[1] https://www.irs.gov/pub/irs-pdf/p554.pdf

[2] Policy loans and withdrawals will reduce available cash values and death benefits and may cause the policy to lapse or affect any guarantees against lapse. Additional premium payments may be required to keep the policy in force.

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Purchasing an annuity within a retirement plan that provides tax deferral under sections of the Internal Revenue Code results in no additional tax benefit. An annuity should be used to fund a qualified plan based upon the annuity's features other than tax deferral. All annuity features, risks, limitations, and costs should be considered prior to purchasing an annuity within a tax-qualified retirement plan.

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Before you make any decisions regarding your financial situation, please consult a financial professional or tax professional to discuss your individual circumstances and objectives.

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